HSBC

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
RIN 7100 AD87
Docket No. R-1430, Docket No. R-1442

Office of the Comptroller of the Currency
250 E Street SW
Mail Stop 2-3
Washington, DC 20219
RIN 1157-AD46
Docket No. ID OCC-2012-0008, Docket No. ID OCC-2012-0010

22 October, 2012

Ladies and Gentlemen,

Re: Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action; Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule

HSBC Holdings Plc ("HSBC Group"), its top-level U.S. subsidiary HSBC North America Holdings Inc. ("HNAH") and its flagship U.S. bank, HSBC Bank USA, N.A. ("HSBC", and collectively with HSBC Group and HNAH, "HBUS", "we", or "us")appreciate the opportunity to comment on the joint notices of proposed rulemaking regarding regulatory capital requirements issued by, among other agencies, the Board of Governors of the Federal Reserve System (the "FRB") and the Office of the Comptroller of the Currency (the "OCC", and collectively with the FRB, the "Agencies").[1] We applaud the hard work of the Agencies in putting together comprehensive Regulatory Capital Proposals, and participated in preparing

[1] The Agencies issued three interrelated notices of proposed rulemaking (the "Regulatory Capital Proposals") implementing (a) *inter alia*, the provisions of the Basel III Accord which apply to all banks, a supplementary leverage ratio measure, and new prompt corrective action rules (the "Capital Adequacy Proposal"), 77 Fed. Reg. 52978; (b) a new standardized approach for calculating risk-based assets which applies as the Collins Amendment floor for all banks, 77 Fed. Reg. 52888; and (c) amendments, generally based on the Basel III Accord, to the so-called "advanced approaches" risk capital rules that apply to the largest and most internationally active banking organizations ("Advanced Approaches Banks"), 77 Fed. Reg. 52792 (the "Advanced Approaches Proposal"). In this letter, we only directly address the Capital Adequacy Proposal and the Advanced Approaches Proposal. The Capital Adequacy Proposal is applicable to HNAH as a U.S. bank holding company and to HBUS as a national bank. The Advanced Approaches Proposal is applicable to HNAH and HBUS because they are large and/or internationally active banking institutions within the meaning of the Advanced Approaches Proposal.

HSBC Holdings plc
Financial Sector Policy Unit, Level 41, 8 Canada Square, London E14 5HQ
Tel: +44 (0)20 7992 1471 Email: charles.haswell@hsbc.com

the comprehensive industry group comment letters submitted with respect to the Regulatory Capital Proposals by The Clearing House and the joint group which includes the American Bankers Association, the Financial Services Roundtable, and the Securities Industry and Financial Markets Association.

We would like to focus our comments on the effects that the Regulatory Capital Proposals, if finalized as proposed, would have on trade finance.[2] We respectfully submit that several aspects of the Regulatory Capital Proposals result in regulatory capital requirements for trade finance exposures that are disproportionate to the relatively low-risk characteristics of such exposures. Disproportionately high regulatory capital requirements may unnecessarily discourage banking institutions from engaging in trade finance activities and inefficiently raise the financing costs of trade finance, both of which may have negative consequences on global trade. Further, as described in more detail below, under the Regulatory Capital Proposals, U.S. banks may well find themselves at a competitive disadvantage with European counterparts.

Trade Finance is Relatively Safe and Vitally Important to World Trade

International trade facilitation is a priority for HSBC. Financing exports and international trade is one of our key strengths, and estimates indicate that HSBC is responsible for over 9% of revenues from bank-financed cross-border trade.[3] HSBC is therefore a key stakeholder in global trade, and stands well positioned to offer its views and perspective.

Trade finance is a relatively low-risk financial activity, as demonstrated by the International Chamber of Commerce's (the "ICC") trade register data, an externally validated survey which was first compiled in 2011.[4] The ICC trade register data shows that between 2005 and 2010, over 11.4 million trade finance transactions with a total notional value of over $5.2 trillion generated fewer than 3000 defaults, a negligible percentage. Even during the global economic downturn (2008-2010), the ICC trade register data indicates that trade financing transactions experienced very low levels of default, with 948 defaults out of more than 4.8 million transactions.

The regulatory capital treatment of trade finance affects the real economy. The availability of low-cost trade finance directly and positively impacts world trade, especially in less favorable economic conditions such as those we are currently experiencing. Therefore, it is important that disproportionately high regulatory capital requirements do not impact the availability of trade finance.

Regulatory Capital Treatment Comments

While HSBC appreciates the efforts of the Agencies to ensure the resiliency and stability of the banking sector, we respectfully submit that certain provisions of the Regulatory Capital Proposals would result in disproportionately high risk capital requirements for trade finance exposures when compared to credit exposures with similar credit features.

---

[2] We support the more detailed letter submitted on this subject by the Bankers' Association for Finance and Trade - International Financial Services Association.

[3] Oliver Wyman Global Transaction Banking Survey 2011.

[4] The ICC survey Global Risks – Trade Finance published 18th January 2012. This survey includes data on trade financing provided by U.S. banks.

1. Treatment of Off-Balance Sheet Trade Finance Exposures under the Supplementary Leverage Ratio

The Capital Adequacy Proposal imposes a supplementary leverage ratio on Advanced Approaches Banks.[5]Off-balance sheet exposures are captured in the denominator of the supplementary leverage ratio by being converted to on-balance sheet asset equivalents. Off-balance sheet trade finance exposures would be included at their notional value and fully attributed to the supplementary leverage ratio denominator. The same treatment applies to other off-balance sheet assets such as derivatives, which are much riskier but have a higher potential yield. This risk-insensitive approach does not properly incentivize banks to focus on safer activities such as trade finance.

We respectfully submit that off-balance sheet trade finance exposures should be included in the denominator of the supplementary leverage ratio at on-balance sheet equivalents of less than their full notional value. In particular, we propose that such trade finance exposures be multiplied by a credit conversion faction ("CCF") of 20% for short-term, self-liquidating trade-related contingencies which arise from the movement of goods and 50% for transaction-related contingencies (including bid bonds, performance bonds, warranties, standby letters of credit related to particular transactions, and performance standby letters of credit). This treatment is consistent with the currently effective general risk-weighed capital rules, which assign lower CCFs for trade finance exposures because of the safe nature of such exposures.[6]

Furthermore, the E.U. is currently negotiating its own revised capital framework to implement the Basel III Accord, commonly referred to as CRR-CRDIV. An approach to inclusion of off-balance sheet trade finance exposures in the denominator of the leverage ratio based on CCFs of less than 100% has been proposed for the CRR-CRDIV,[7] and we are optimistic that it will be adopted. In order to effectuate this approach, the CRR-CRD IV proposals would apply CCFs similar to our proposal above. If these proposals are finalized as proposed, and the Regulatory Capital Proposals are finalized as proposed, U.S. banks would be at a competitive disadvantage relative to European banks. We urge the Agencies to consider ensuring international regulatory harmonization when drafting the final regulatory capital rules.

Asset Value Correlation Factor Multiplier for Trade Finance Exposures

To protect against systemic risk stemming from exposures among large financial institutions, the Advanced Approaches Proposal applies a multiplier of1.25 to calculation of the asset valuation correlation factor ("AVC factor") for exposures to large or unregulated financial institutions using the following formula:[8]

$$\text{AVC factor} = R = 1.25\times(0.12+ 0.18\times e-50\times PD)$$

---

[5] Proposed Rule 8_.10.

[6] *See e.g.* 12 C.F.R. Part 225 Appendix A.III.D.

[7] Article 416 Clause 8 (b),(ba) and (bb) of proposal lor a regulation of the European Parliament and of the council on prudential requirements for credit institutions and investment firms (June 12, 2012).

[8] Proposed Rule 8_.131.

This approach applies the multiplier to the AVC factor formula for HVCRE exposures, as opposed to the AVC factor formula for non-HVCRE wholesale exposures(which produces lower values). This approach would therefore result in materially higher AVC factors for exposures to large or unregulated financial institutions. It would also amount to a significant departure from the Basel III Accord. Specifically, under the Basel III Accord the 1.25 multiplier is applied to the correlation formula for general wholesale exposures as opposed to the correlation formula for HVCRE exposures.[9]

While we understand the Agencies' objective is to protect against systemic risk, trade finance products would also be captured by the increased risk weight that would result from the higher AVC factors produced by applying the multiplier to the formula for HVCRE exposures. We believe that because they are short-term, self-liquidating instruments the risk profile of trade finance products is low, and therefore they should be subject to lower AVC factor values, which better reflect trade financings' level of risk. Applying the multiplier to the HVCRE formula will also result in higher capital charges for U.S. based banks than for non-U.S. competitors, putting U.S. banking institutions at a disadvantage. We ask the Agencies to consider that this lack of international consistency and harmonization may result in market distortions, and to adopt a more uniform approach. Accordingly, we respectfully submit that with respect to trade finance exposures, the multiplier for exposures to large or unregulated financial institutions should be applied to the formula for non-HVCRE wholesale exposures, i.e., (0.12+ 0.12×e−50×PD).

2. Maturity Floor for Trade Finance Instruments

The Advanced Approaches Proposal appears to exempt from the maturity floor minimum of one year all relevant trade finance instruments, allowing the original maturity of the instrument to be used in risk weight calculations. This treatment is consistent with prior guidance from the Agencies, which confirmed that short-term, self-liquidating trade finance instruments are exempt from the one-year maturity floor.[10] Due to differences in wording, we respectfully ask for confirmation that all short-term, self-liquidating trade finance instruments are indeed considered exempt from the one-year maturity floor, as they do not constitute an ongoing financing of the obligor.

Conclusion

Global trade is underpinned by accessible and affordable financing for trade transactions. Trade finance plays an important risk mitigating function for supply chain management, and is especially vital for small and medium enterprises and low income countries which rely to a greater extent on trade products to finance working capital and business growth. Protecting trade finance is particularly important now, at a time when both the U.S. and the broader global economy are in need of viable and sustainable ways to promote economic growth.

---

[9] Under the Basel III Accord, the AVC factor formula for exposures to large or unregulated financial institutions, which includes a 1.25 multiplier, is expressed as: Correlation (R_FI) = 1.25 x [0.12 x (1 - EXP(-50 x PD)) / (1 - EXP(-50))+ **0.24** x [1 - (1 - EXP(-50xPD)) / (1 - EXP(-50))]]. The correlation formula for exposures to corporates, sovereigns and bank (wholesale exposures) is: Correlation (R) = 0.12 × (1 – EXP(-50 × PD)) / (1 – EXP(-50)) + **0.24** × [1 – (1 – EXP(-50 × PD)) / (1 – EXP(-50))]. By contrast, the correlation formula for HVCRE exposures is: Correlation (R) = 0.12 x (1 – EXP(-50 x PD)) / (1 – EXP(-50)) + **0.30** x [1 – (1 – EXP(-50 x PD)) / (1 – EXP(-50))]. *Compare* the Basel III Accord ¶ 102 *with* the Basel II Accord ¶ 283.

[10] Letter from the FRB and the OCC to the Bankers' Association for Finance and Trade (June 7, 2012).

We support the Agencies in taking strong steps to build a robust and resilient financial sector, but would respectfully ask the regulatory treatment of trade finance be re-examined. As low-risk, self-liquidating transactions which are supported by the movement of goods and services, trade finance exposures should receive a risk-appropriate regulatory treatment as set forth above.

Please feel free to contact me at + 44 (0) 20 7992 1471 or Kevin Fromer Executive Vice President Government Relations HNAH at (202) 4663561 if you have any questions or would like any additional information.

Yours Sincerely,

Charlie Haswell

Charles Haswell
Global Head, Financial Sector Policy